STAGES RETIREMENT

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SPECIAL ISSUE OF STAGES MAGAZINE

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to our readers

Dear retirement investor:

As more and more people begin to retire and draw from their savings, they are finding that they simply don't have enough. Studies show that only about one in five retirees today has a formal plan for managing assets, income, and expenses during retirement. And many retirees who do have plans often have based them upon faulty assumptions about how long their retirements will last and how their investments will perform.

At Fidelity, we are introducing a new suite of services, Fidelity Retirement Income Advantage℠, designed to help current and prospective retirees understand today's major retirement challenges and take the appropriate steps to meet them. As part of this effort, we have created a special issue of our *Stages* magazine, and I am pleased to present it to you.

Using the real life experiences of retirement investors, this issue gives you useful information on:

- **Making retirement savings last a lifetime**
- **Coping with inflation**
- **Choosing a portfolio strategy that can weather market volatility**
- **Determining a comfortable withdrawal strategy**
- **Meeting health care expenses**

We've also included an overview of the Fidelity tools and resources that are available to help you analyze your retirement situation, determine your investment comfort level, and create an action plan to help you meet your goals.

Please let us know what you think of this special issue and give us any ideas you might have for other topics we can address in the future. The e-mail address is stages@fmr.com. Our goal at Fidelity is to help you plan for a secure retirement, and then live comfortably through it. We hope you will use this information to your best advantage.

Sincerely,

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Investors are coming to grips with new retirement challenges — and reaping new rewards.

By Clint Willis

Retirement is the beginning of a new and potentially rewarding life — one that brings with it a variety of new challenges. If you have already retired, you are likely well aware that financial security and comfort are achieved only through careful planning and active management. If you are nearing retirement, envisioning your future will be much easier once you've taken a look back to assess how well — and how much — you have saved.

In either case, the many financial considerations you're juggling are closely related to one fundamental question: How can I ensure that my retirement savings and other resources last a lifetime?

Unfortunately, there's no across-the-board answer for the more than 35 million Americans who are over the age of 65 right now. Even experienced investors need help when it comes time to turn their retirement savings into income.

Experts note that retirement planning changes dramatically once people leave the workforce. At that point, they've often finished saving — and must concentrate on making their money last. That task is complicated by today's longer life spans, volatile financial markets, and soaring health care costs. The penalty for ignoring these new realities can be harsh: running short of money during retirement.

Today, more than ever, Americans who seek secure and comfortable retirements face two crucial tasks: accumulating savings for the future and finding ways to make that money last a lifetime.

Shooting from the hip

Many have tackled the first task head-on — but have been slower to address the challenges of preserving and distributing their wealth once retirement begins. "Many people heading toward retirement understand the need to save," says Farrell Dolan, executive vice president of Fidelity's Income Services Group. "Meanwhile, there is a tremendous lack of understanding of the risks they face *during* retirement — a time when it becomes much more difficult to recover from a serious mistake or setback."

Only about one in five retirees has a formal, written plan for managing income, assets, and expenses during retirement, according to a 2003 study by LIMRA International, Inc., a life insurance marketing research organization. Retirees who do have plans frequently base them on faulty assumptions about how long their retirements will last or how much their investments will earn. "Even strong savers often shoot from the hip when it comes to actually planning their retirement finances," observes Carol C. Pankros, a fee-only financial planner at CCP, Inc. Financial Services, in Palatine, Ill.

Risky business

Whether you plan to travel the world, start a new career, or just take it easy, you need a strategy for facing an array of risks that will confront you as a member of the next generation of retirees. The most serious risks are related to five crucial issues:

Longevity Will you live longer than you expect?

Inflation Can you protect the purchasing power of your savings?

Asset allocation Will your investments grow quickly enough to sustain your lifestyle?

Withdrawal rates How much can you withdraw from your savings without depleting them too soon?

Health care costs Are you prepared to meet the soaring costs?

The first step to meeting these challenges is to understand them clearly so that you can formulate a successful response. "Retirement is the beginning of a whole new stage in your life and, as such, it brings a new set of challenges," says Linda Gadkowski, a certified financial planner in Centerville, Mass. "It's important to face those issues squarely — and as soon as possible."

Once you do that, you'll be better prepared to overcome these risks and enjoy the retirement of your dreams. With that in mind, here's a rundown of the five risks to retirement income and some hints for how to cope with each one.

LONGEVITY "RISK"

Thanks to a century of stupendous advances in medical technology, many of yesterday's sure-fire killers are today curable or merely chronic. As a result, there's a very good chance that your retirement will last for 20, 30, or even 40 years — which means your retirement savings and other financial resources also must last that long.

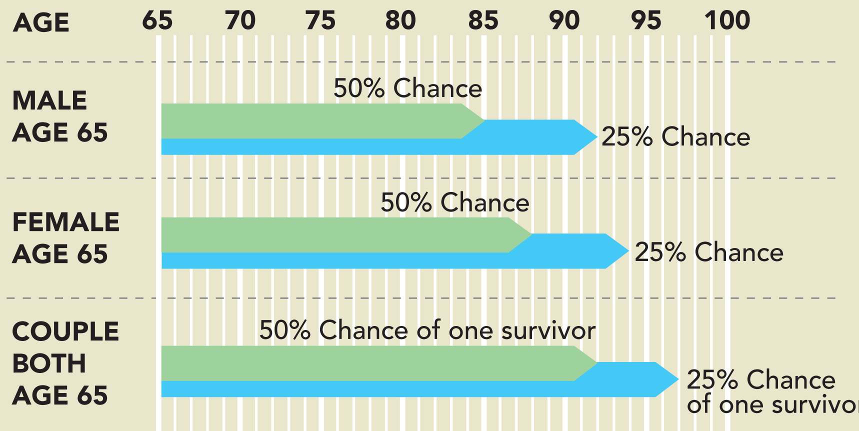
"People who don't plan for greater life expectancies risk running out of money in retirement," says Pankros. "Imagine running out of money when you're 75 or 80. You have to make sure that doesn't happen."

This risk poses a special threat to the many Americans who dramatically underestimate how long they are likely to live. Those folks forget a crucial fact: The longer you have lived, the longer your expected total lifespan. For example, a man who has managed to reach age 65 in good health has a 50% chance of

"Imagine running out of money when you're 70 or 80. You have to make sure that doesn't happen."

Retirees need to plan for the possiblility of longer life expectancies

Chances of living to a given age.



Source: Annuity 2000 Mortality Table; Society of Actuaries. Figures assume a person is in good health.

"Retirement always seemed so far away, but these are short-term issues for us now."

Sharon Hanley-DeCoste
Plymouth, Massachusetts

Taking a setback in stride

Sharon Hanley-DeCoste, 58, has a clear vision of retirement: travel, reading, and long walks on the beach near the Plymouth, Mass., home she shares with her husband, David, 61. But the picture blurs a bit when it comes to timing. "I had hoped to retire at 62," says Sharon, a radiology manager at a local hospital. "Now I'll probably wait until I'm 65."

That uncertainty reflects an unanticipated turn of events that occurred when David took early retirement from a major telecommunications company, in 2002. He planned to work as a consultant for the firm — but the promised assignments didn't materialize. Although David is receiving a pension, the couple's income is less than they had planned for.

Fortunately, the DeCostes have accumulated significant savings during their 39-year marriage. David hasn't yet touched his early-retirement settlement or his 401(k) savings. Moreover, the couple is taking action to adjust to their new situation. This year Sharon plans to significantly boost her contributions to her 403(b) plan, allowing her to take full advantage of her employer's 50% matching funds. She's also saving more through a tax-deferred annuity that she's expecting will generate additional income when she retires.

And there are other reasons to save more. Sharon cites health care and inflation as two other considerations. "Health care costs are spiraling out of control — so I have huge concerns about that," she says. "The strong housing market has boosted the value of our house, but we don't plan to sell it and move. Meanwhile, everything we eat or wear or put in the gas tank gets more expensive."

The DeCostes haven't yet completed a formal retirement plan, but they intend to create one soon — which will allow Sharon to settle on a realistic retirement date. "Retirement always seemed so far away, but these are short-term issues for us now," she acknowledges. "Fortunately, we're taking steps to address them. I'm confident that if we continue to save and keep an eye on our spending, we'll have the income we need."

living to age 85 and a 25% chance of living to age 92.

Women should plan for even longer life expectancies — and couples have to be especially careful. Consider a couple who both reach age 65 in good health. There is a 50% chance that either the husband or wife will reach the age of 92. "The longer you live, the greater the chance that you could outlive your savings," says Steven Merkel, a certified financial planner with Investor Solutions Inc., in Coconut Grove, Fla.

INFLATION RISK

If you're reading this, you're probably old enough to remember the double-digit inflation rates of the early '80s. The Consumer Price Index peaked at a scary 13.5% in 1980 before declining to the much lower levels of recent years.

The United States has enjoyed a modest annual inflation rate of

Photograph by Paul Foley

2.7% since 1990. Trouble is, even a modest rate of inflation will wreak havoc with your retirement expenses over 20 or 30 years. At a 3% annual inflation rate, a retired couple with living expenses of roughly $72,000 in 2003 would need more than $150,000 — an increase of more than 100% — to meet their annual expenses in 25 years.

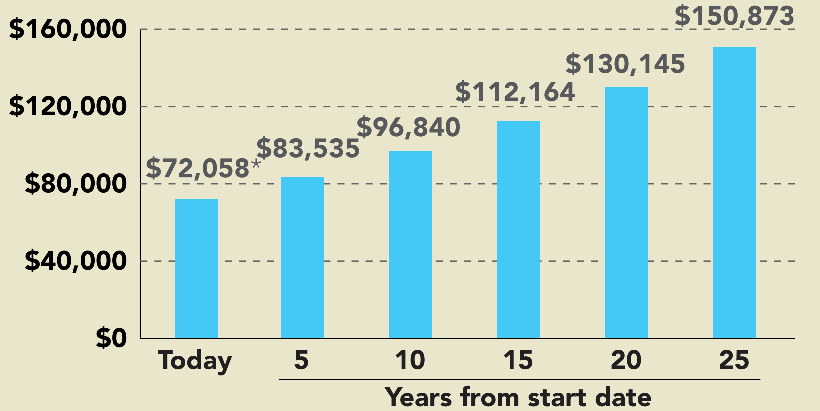
What's more, such figures may well understate inflation's potential impact on your retirement living expenses. At a 4% inflation rate, the same couple's expenses would more than triple in 25 years, reaching $244,000. "We've been very fortunate with inflation in recent years," says Morris Armstrong, a certified financial planner in New Milford, Conn. "But low inflation isn't likely to last forever."

It's also worth noting that some retirement expenses are likely to rise faster than the overall rate of inflation. A study by Families USA found that prices for the 50 drugs most commonly prescribed to older Americans increased 3.4 times the rate of inflation from January 2002 to January 2003, compared to just under three times inflation in the previous year.

The high likelihood of continued inflation makes investments that have the potential to beat inflation imperative.

Even low inflation can slash your buying power

In 25 years, at just a 3% annual rate of inflation, your expenses could more than double what they are today.



*$72,058 was the annual expenditure for individuals age 65+ with income greater than $70,000 from the U.S. Department of Labor, Bureau of Labor Statistics, Consumer Expenditures 2000 report. All other numbers were calculated based on a hypothetical 3% rate of inflation (historical average from 1926 to March 2003 was 3.06%) to show the effects of inflation over time; actual inflation rates may be more or less.

Older workers, as well as retirees, need to remember that they can benefit from the long-term potential of growth investments such as stocks.

ASSET ALLOCATION RISK

Many things are simpler when you're young — and asset allocation is one of them. Young workers with decades to go until retirement can afford to ride out market downturns. Thus, they may be inclined to invest heavily in volatile, growth-oriented assets such as stocks or stock funds.

Retirees — and people nearing retirement — face a more delicate balancing act. They have less time and fewer opportunities to recover from market setbacks, so a serious bear market can disrupt their retirement plans. Result: Many older investors err on the side of caution by drastically reducing their growth-oriented equity holdings.

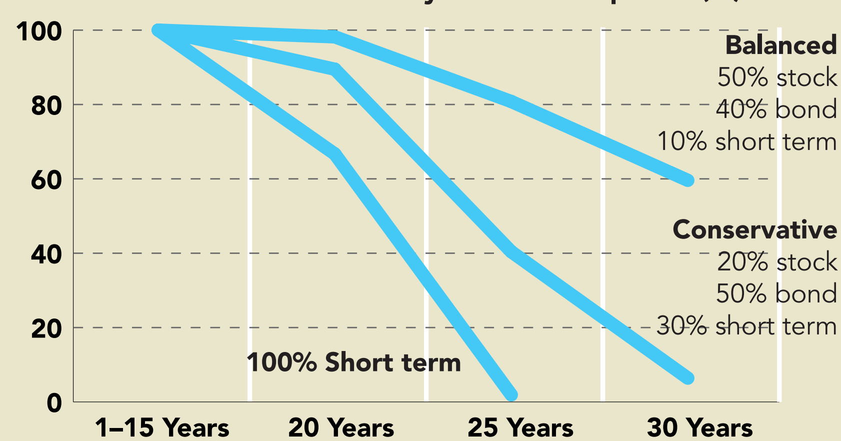
That can be a terrible mistake. Older workers, as well as retirees, need to remember that they can benefit from — and may require — the long-term potential of growth investments such as stocks.

True, a portfolio of income investments may protect you from the worst losses of a bear market. But such a portfolio could also greatly increase the risk that you'll outlive your savings. How big is that risk? The chances that you'll exhaust an all-cash portfolio in 25 years are nearly 100%, assuming a 5% annual withdrawal rate. That compares to

Stocks for the long haul

Longer planning horizons require greater exposure to equities. Stock allocations of less than 50% have historically led to lower success.

Historical likelihood that assets may last for each period (%)



Source: Fidelity Investments. Hypothetical value of assets held in an untaxed portfolio of stocks, bonds, and short-term investments with inflation adjusted withdrawals of 5%. Please refer to the Important Legal Information page for important information about the methodology used in this chart and index information. Historical monthly data from 1926 through 2003 is from Ibbotson Associates; stocks, bonds, and cash are represented by S&P 500,® U.S. Intermediate Government Bonds, and U.S. 30-day T-bills. Average 3% inflation rate assumed (historical average from 1926 through March 2003 was 3.06%). Actual inflation rates may be more or less. This chart is for illustrative purposes only and is not indicative of any investment. Past performance is no guarantee of future results.

"I figure we'll have to buy [health] insurance at some point to cover us until we're old enough for Medicare."

Ron Burns
Georgia, Vermont

20% for a portfolio that is balanced among stock (50%), bonds (40%) and cash (10%).

In short, a diversified investment portfolio that balances factors such as growth, income, and stability is a key to investment success. That rule is true for young workers starting out in life, and it remains equally true for retirees. "A diversified portfolio is like a balanced diet," says Gadkowski. "You don't stop needing it when you retire." Note that neither diversification nor asset allocation ensures a profit or guarantees against loss. Also, the principal value and investment return of any security will fluctuate, and when redeemed may be worth more or less than the original cost.

EXCESS-WITHDRAWAL RISK

You can't control inflation, investment returns, or (though you can try) your lifespan. But you do get to decide how much to withdraw from your retirement savings each year — and that choice will have a huge impact on how long your money lasts.

Photograph by Bill Truslow

Attentive to allocation

Ron Burns' plan for making the most of early retirement includes a thoughtful allocation of both his time and his assets. Since retiring last year, at age 53, the former production manager for a major pharmaceutical firm has been spending most of his time gardening, fishing, and running a 14-acre farm in Vermont. "It all keeps me pretty busy, but it's fun," says Burns.

As for allocating his assets, Burns has sought a similarly successful balance since he began seriously saving for retirement, back in his mid-30s. Burns contributed the maximum amount to his 401(k), and his employer matched half his contributions, up to 6% of his salary. He divided the money among mutual funds and his company's stock, which delivered strong long-term gains, helping him to retire early.

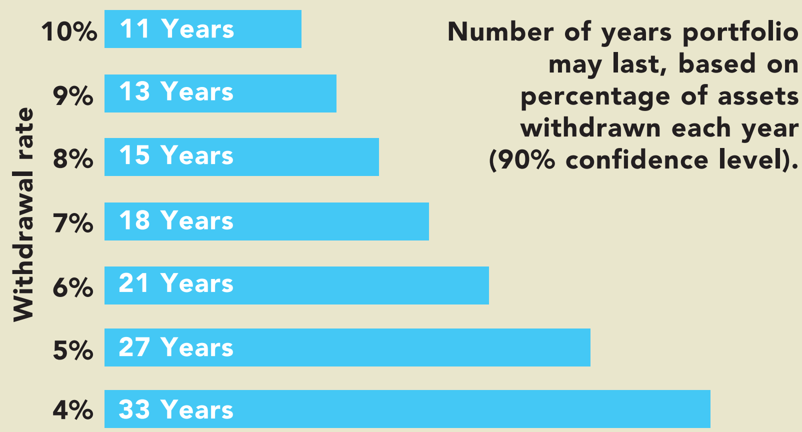
Today, his retirement savings consist of a selection of mutual funds and short-term investments he holds in a pair of Rollover IRAs. The first, which represents about 75% of the assets he had accumulated through his 401(k) plan, is invested about one-third in CDs and the remaining two-thirds in mutual funds for growth and income. Burns describes this as "an income-generating IRA from which I'd draw the amount I legally could for systematic payments."

A second Rollover IRA holds the balance of his retirement assets, which Burns has allocated among three mutual funds — an international fund, a large-cap fund, and a small-cap fund. So far, so good, according to Burns, who closely monitors overall performance and diversification.

Health coverage during retirement is not a concern for Burns, who is covered by his wife's policy. "I figure we'll have to buy insurance at some point to cover us until we are old enough for Medicare," he says.

Burns is confident that his financial resources will be sufficient to see him through retirement. "I hope that there will be enough there to leave something to help my family as well," he adds. "Meanwhile, I feel very fortunate to be in this position."

The impact of withdrawal rates on a portfolio



Source: Fidelity Investments. Hypothetical value of assets held in an untaxed account of $500,000 invested in a portfolio of 50% stocks, 40% bonds, and 10% short-term investments with inflation-adjusted withdrawal rates as specified. Please refer to the Important Legal Information page at the back of this publication for important information about methodology and index information. This chart's hypothetical illustration uses historical monthly performance from January 1972 through January 2003 from Ibbotson Associates: stocks, bonds, and cash are represented by S&P 500,® U.S. Intermediate Government Bonds, and U.S. 30-day T-bills. This chart is for illustrative purposes only and is not indicative of any investment.
Past performance is no guarantee of future results.

Many retirees withdrew large sums from their savings each year during the '80s and '90s. After all, the stock market would continue to deliver double-digit returns each year to replace that money — wouldn't it?

The recent bear market answered that question in the negative. Some retired people were forced to cut back on spending and adopt more conservative withdrawal strategies. Other retirees returned to full-time jobs to rebuild their savings — a move that surely wasn't part of their original retirement plans.

The key thing to know: Even a modest change in the amount you withdraw each year can make an important difference in your long-term financial prospects. The chart shows how long a balanced investment portfolio (50% stocks, 40% bonds, 10% short-term investments) could potentially last at various withdrawal rates. The money has a 90% chance of lasting 33 years at a 4% withdrawal rate. Raise the withdrawal rate to 6%, and that figure drops by more than a third — to 21 years.

What's the right withdrawal rate for you? The answer depends upon a range of issues — from your age and health at retirement to the size and composition of your portfolio.

HEALTH CARE EXPENSES RISK

Your physical health may have a major impact on your financial health in retirement. Health care costs are soaring again — rising 8.7% in 2001, versus a 2.8% rise in the general inflation rate.

Your generation's improved life expectancy means that most of you will probably be around to shell out big bucks for medical expenses. How big? A December 2003 study by Fidelity Employer Services Company found that a couple retiring now at age 65 would need $175,000 in current savings just to supplement Medicare and pay other out-of-pocket health care costs in retirement. That figure rises significantly for a couple who retire at age 60. Of course, those figures are overstated for couples whose employers provide retirement health care coverage.

Then there are long-term-care costs for nursing homes and other services. Some people may decide to cover such costs through long-term-care insurance — but remember that such policies are most affordable if you purchase them at a relatively early age.

"The name of the game is to make sure we'll have enough to last the rest of our retirement years."

Jimmy & June Hall
Sun City West, Arizona

Photograph by David Schmidt

Meeting the challenge

Planning and managing for retirement today is more complex than ever before. In addition to the five key risks explained in this special issue, you'll face several challenges as you transition from full-time work and wealth accumulation to retirement. That's why it's important for you — whether you are already retired or just contemplating retiring — to do all you can to make sure your income lasts through your lifetime.

Now's the time to familiarize yourself with the process of developing a realistic income plan — a detailed, written plan that you feel confident will carry you through your retirement. Generally speaking, such a plan entails envisioning your ideal retirement, estimating both your income and expenses, and seeking to ensure you do not outlive your assets.

Voice of experience

Jimmy Hall, after more than 50 years of investing and 18 years of retirement, knows at least two things for sure. "I don't know what will happen to stocks over the next year or two, but I do know that I don't want to go back to work," says the 77-year-old, with a chuckle. But Hall is well aware that investing in retirement is serious business. "The name of the game is to make sure we'll have enough to last the rest of our retirement years," says Hall.

Hall figures that maintaining a well-diversified portfolio is perhaps the most important strategy he can follow. "Our investments are spread around, so they provide growth and stability," he says. The Halls' current mix, which they established with the help of a financial adviser, includes 56% in stock funds, 33% in fixed-income securities, and 11% in cash and other short-term investments.

Regular meetings with their financial adviser help to keep the Halls on track, according to Jimmy. "He helps me invest my money so that it's not all in one basket. When we meet, he gives me a pie chart showing the portfolio. We're comfortable with it."

There was a time when the Halls were anything but comfortable when they thought about retirement. Looking back, Hall now knows that, at the time, his investments were too narrowly focused on a single stock. "We had real worries," he recalls. "Running out of money was our main concern."

Today, a lack of diversification is a gamble the Halls are not willing to take. Instead, they are focused on maintaining their health and their lifestyle, which includes golf, travel, and regular bridge games. The couple have also set up a trust for their only child — a daughter — who had her own child (a girl) last year.

"We're very pleased with our financial situation and our investments," says Hall. "I love being retired — and I feel very fortunate to be in this position."

"Things cost more every day — and some of my investments aren't keeping up. The increase in the cost of living is really scary."

Nuria Frankel
Boca Raton, Florida

Managing on her own

Nuria Frankel readily admits that her retirement plan is not without some uncertainty. In terms of overall net worth, the 59-year-old widow is more than financially secure. But, looking ahead, she is concerned about inflation, longevity, and the current structure of her portfolio.

A significant portion of Frankel's portfolio is in real estate — specifically, two new homes that are being marketed by the family's home-building business. Unfortunately, they have been slow to sell. "Meanwhile, I'm not making anything on those investments," says Frankel. "I'm waiting for the money in real estate to come through before I invest more."

The remainder of Frankel's retirement nest egg is in stocks, IRAs, annuities, and CDs. And while she's comfortable with the generally conservative overall mix of her non–real estate holdings, she's well aware of the impact of inflation. "Things cost more every day — and some of my investments aren't keeping up," she says. "The increase in the cost of living is really scary."

That's one of the reasons she has chosen to work as a bookkeeper for the family business, which has been run by her son since the death of Frankel's husband, in 2002. Her husband had always managed the family's investments and finances, according to Frankel, who is still getting accustomed to making these important decisions.

Frankel has even begun to think about planning for the long term, since longevity runs in her family. "My grandmother lived to be 101," says Frankel, who knows it's important to develop and follow a strategy that will provide income for life. "I hope I don't run out of money before I die."

Then again, Frankel takes heart from the fact that she owns a beautiful home — the mortgage is fully paid off — a broad array of investments, and a stake in the family enterprise. "Once we sell a couple of houses, I may shift some money to growth investments," she says. "For now, though, there's enough uncertainty in my financial life."

Developing your plan

Here's a checklist of the steps you'll want to take as you build your personal retirement income plan.

STEP 1: Estimate expenses

Your first step is to estimate your monthly or annual expenses. After developing an itemized list, divide the entries into essential and discretionary expenses. Essential expenses are those things you can't live without — food, housing, clothing, health care, and insurance. Examples of discretionary expenses include travel and entertainment.

STEP 2: Estimate income

Now you're ready to similarly estimate your sources of income in retirement. Draw up an inventory of the income, assets, and accounts available to fund your retirement. These may include Social Security, traditional pensions, lifetime annuities, or other predictable long-term

Photograph by Nancy Brown

income flows. Don't forget investments and other assets such as stocks, bonds, mutual funds, CDs, real estate, and rental income. Estimate the income these may generate and add it to your predictable income flows. The sum is your total expected income.

STEP 3: Compare expenses and income

Using the information you've compiled, you're now ready to compare your expected essential expenses with your projected income. The key is to determine if your predictable sources of income will cover your essential expenses. In addition, evaluate whether or not your less predictable assets are sufficient to fund your discretionary expenses.

STEP 4: Allocate your assets

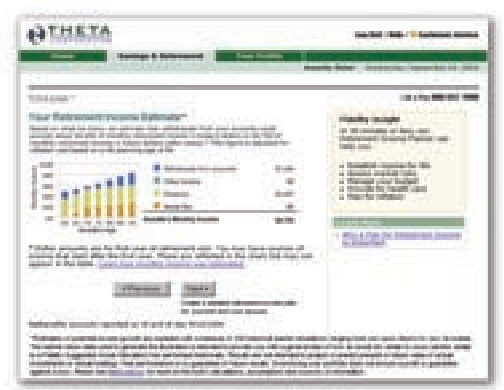
The goal here is to put in place an asset allocation strategy based on your time horizon, risk tolerance, and investment experience. Make sure your portfolio is structured to help minimize the five risks outlined in the main article.

STEP 5: Monitor and maintain

With your retirement income plan in place, it becomes important to review it regularly — at least once a year. As your personal circumstances change, you'll want to adjust accordingly.

Fidelity Retirement Planning Tools

Retirees and retirement-bound investors are fortunate to be able to draw upon a growing body of knowledge and resources about the risks and rewards of modern retirement. What's more, they can take advantage of increasingly sophisticated techniques to help them manage the financial uncertainties they are likely to face.



"The financial community is getting better at dealing with these issues," says Van Harlow, president of asset management services at Strategic Advisers, Inc., a registered investment adviser and a Fidelity Investments company. "We're building new tools to help people investigate scenarios they might encounter during retirement, ranging from high inflation rates to shifts in financial markets. We're also using new technologies, ranging from the Internet to emerging mathematical models, to help investors make better financial decisions. And that's all happened in just the last few years."

Fidelity has developed its **Retirement Planning Tools** to help you answer the most important question of all: "Will my money last a lifetime?" These easy-to-use planning tools will guide you through the steps needed to structure your plan. They can help you analyze your anticipated expenses in retirement and determine whether your expected sources of retirement income are likely to fund the retirement lifestyle you envision.

Once completed, your plan will provide a clear checklist of suggested steps to manage your investments as well as your income in retirement. Log on to Fidelity NetBenefits® at **http://netbenefits.fidelity.com** to access the tools.

resources

Fidelity is here to help

Creating and managing a retirement income plan can be challenging. Where do you begin? How do you ensure it stays on track?

Assistance by phone
Give us a call

Fidelity Retirement Specialists are available to answer your questions about beginning the process of developing an income plan. They can also assist you in reviewing income planning materials and using the Retirement Planning Tools. If you are retired or planning for your retirement, ask about getting set up with a Fidelity Income Planning Specialist for an in-depth income planning consultation.

Call **1-800-557-1900** to speak to a Fidelity Retirement Specialist

Online resources
Retirement Planning Tools

Additionally, Fidelity has developed Web-based tools that will guide you through the steps needed to structure your personalized plan. In 30 minutes or less, these tools can help you:

- Establish how much income you need for life
- Assess market risk
- Manage your budget
- Provide a budget for health care
- Plan for inflation.

The fastest and easiest way to get started is by logging on to Fidelity NetBenefits® at **http://netbenefits.fidelity.com** to access the tools.

Online resources
Fidelity NetBenefits

NetBenefits℠ is a comprehensive resource for retirement planning — a password-protected site that is designed to help make managing your retirement plan as simple as possible. Log on today to:

- Review your retirement account
- Read about a variety of personal finance topics
- Choose investments that can help you achieve your financial goals.

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Online resources
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Review your account at **http://netbenefits.fidelity.com**

resources

Online resources
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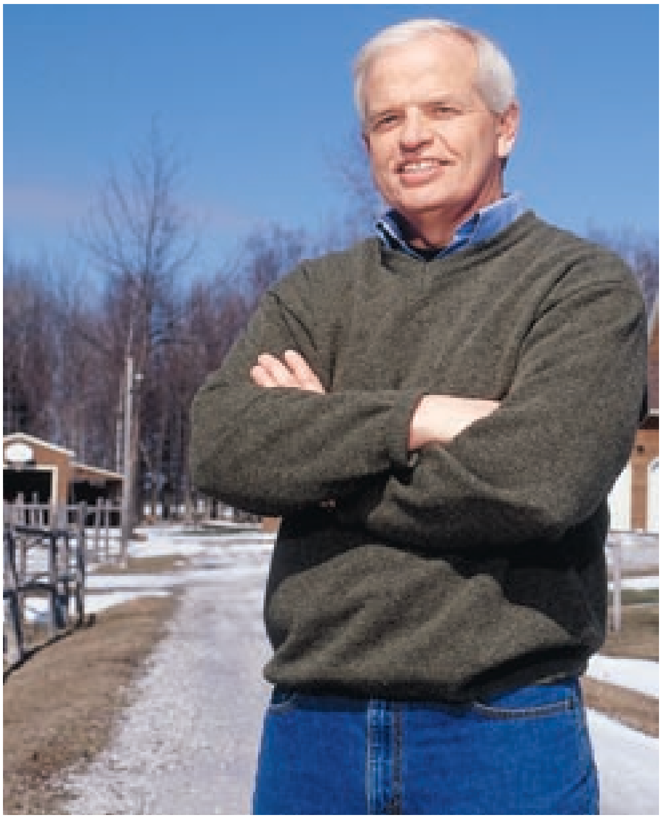
Thanks to recent tax law changes, you have greater opportunities than ever to save for a more secure retirement. Learn more by taking The 60-Second Retirement Challenge℠.

Take the 60-Second Retirement Challenge at
www.fidelity.com/atwork/60second

Online resources
Retirement Resource Center

Whether you expect to retire in three months or 30 years, you probably have questions about planning for retirement. Fidelity's resources can help you get the answers.

Visit the Retirement Resource Center at
www.fidelity.com/retirement



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LOOKING FOR ANSWERS

How can I ensure that my retirement savings and other resources last a lifetime? Like all retirees, Ron Burns (left) is facing that challenge now that he's called it quits, at age 53. Inside, you'll learn more about Burns' plan for allocating his assets, monitoring his savings, and making the most of an early retirement.

READ THE FULL STORY INSIDE ON PAGE 7

LIVE LONG AND PROSPER

You may be around to enjoy your retirement for a long time. See your odds of living to be 100.

Turn to page 3

DON'T GIVE UP ON STOCKS

History shows that you're likely to need stocks if your money is to last up to 30 years.

Check out the figures on page 6

HOW LONG WILL YOUR MONEY LAST?

THE RIGHT **WITHDRAWAL RATE** CAN MAKE ALL THE DIFFERENCE.

More on page 8

FOR INVESTORS IN RETIREMENT

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